

September 27, 2012

Practice Groups:**Investment
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SEC Issues Proposed Rules to Permit General Solicitation and General Advertising in Certain Private Offerings

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On April 5, 2012, the Jumpstart Our Business Startups Act (“JOBS Act”) became effective.¹ The JOBS Act mandated, among other things, that the Securities and Exchange Commission (“SEC”) amend Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933, as amended (“Securities Act”) to permit general solicitation and general advertising (collectively “general solicitation”) in connection with certain “private” offerings of securities.² The JOBS Act also mandated that the amendments to Rule 506 require issuers to take reasonable steps to verify that purchasers of the securities are accredited investors, using methods determined by the SEC. The SEC proposed such amendments on August 29, 2012 (“Proposing Release”).³

Specifically, if adopted, the proposed amendments would:

- permit general solicitation in securities offerings under new Rule 506(c) of Regulation D provided that all purchasers are “accredited investors” as defined in Rule 501(a) of Regulation D;⁴
- provide that issuers must take “reasonable steps” to verify the accredited status of investors as a condition of the exemption in Rule 506(c) offerings in which general solicitation is used. The verification requirement would be in addition to the requirement that purchasers be accredited investors: it is a condition to the Rule 506(c) safe harbor even if all the purchasers in fact meet the standards of one or more of the enumerated categories in the Rule 501 definition of accredited investor, or the issuer reasonably believes that they meet them, unless the issuer has actual knowledge that an investor meets such requirements.
- preserve an issuer’s option to conduct a private offering under renamed Rule 506(b) without engaging in general solicitation and without subjecting itself to the new requirement to take reasonable steps to verify that the purchasers are accredited;

¹ To view our prior alert that contains a more detailed discussion of the private offering provisions of the JOBS Act, please click [here](#). To view our previous alert that addresses the entire JOBS Act, please click [here](#).

² Section 4(a)(2) of the Securities Act provides an exemption from registration for transactions by an issuer “not involving any public offering.” Rule 506 of Regulation D provides a safe harbor under Section 4(a)(2). “General solicitation” is not specifically defined in Regulation D or elsewhere in the Federal securities laws. However, Rule 502(c) of Regulation D provides some examples of general solicitation, such as advertisements published in newspapers and magazines, communications broadcast over television and radio, and seminars whose attendees have been invited by general solicitation. In addition, the SEC staff has issued interpretive letters, and the SEC has issued interpretive releases and made decisions in enforcement actions giving some further guidance. For example, the SEC has stated that other uses of publicly available media, such as publicly accessible websites, also constitute general solicitation. See *Use of Electronic Media for Delivery Purposes*, SEC Release No. 33-7233 (Oct. 6, 1995); *Use of Electronic Media*, SEC Release No. 33-7856 (Apr. 28, 2000).

³ See SEC Release No. 33-9354.

⁴ The definition of “accredited investor” includes any investor that comes within certain enumerated categories or who the issuer “reasonably believes” comes within any of such categories. The categories include, among other persons, individuals that meet net worth or income tests and various types of entities that meet asset and other tests.

- amend Form D to provide boxes to check if the issuer is relying on Rule 506(b) or Rule 506(c); and
- permit general solicitation in offerings under Rule 144A provided that securities are purchased only by Qualified Institutional Buyers (“QIBs”) (as defined in that Rule).

Notwithstanding some limited guidance from the SEC on the subject of general solicitation, its definition and the scope of permitted general solicitation activities remain unclear (see note 2).

I. Proposed Amendments to Rule 506 and Form D

The Proposing Release would create a new Rule 506(c) safe harbor from registration of offers and sales of securities under the Securities Act in which general solicitation is used.⁵ Rule 506(c) would permit issuers to conduct exempt securities offerings by means of general solicitation under the following conditions:

- each purchaser of the securities must actually meet the requirements to be an accredited investor in one of the enumerated categories in Rule 501 of Regulation D or the issuer must reasonably believe that the purchaser of the securities meets such requirements (see note 4 above);
- the issuer must take reasonable steps to verify that the purchasers of the securities are “accredited investors” as defined in Rule 501 of Regulation D; and
- all terms and conditions of Rule 501 and Rules 502(a) and 502(d) of Regulation D must be satisfied.⁶

Verification of Accredited Investor Status under Rule 506(c)

Proposed Rule 506(c) would mandate a “facts and circumstances”-based verification process in lieu of rigid rules or non-exclusive guidelines. The issuer would be required to “take reasonable steps to verify that purchasers” in a 506(c) offering are accredited investors. This verification requirement would be in addition to the requirement that the purchasers actually meet the accredited investor requirements or that the issuer reasonably believes that they meet such requirements. Under this standard, issuers would be required to consider the particular conditions surrounding the offering to verify each purchaser’s accredited investor status. Despite providing necessary flexibility, a facts-and-circumstances-based verification test without rigid rules or non-exclusive guidelines could make it difficult for an issuer to know whether it has met the verification requirement. Accordingly, the Proposing Release sets forth the following examples of relevant factors to assist an issuer in conducting the verification:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- the amount and type of information that the issuer has about the purchaser;
- the manner in which the purchaser was solicited to participate in the offering; and
- the terms of the offering, particularly a minimum investment amount.

⁵ Section 4(a)(2) of the Securities Act provides an exemption from registration of securities offerings “not involving any public offering.” Proposed Rule 506(c) of Regulation D would provide a new safe harbor under Section 4(a)(2).

⁶ Rule 501 sets forth qualification and numerical thresholds to be an “accredited investor,” as well as certain definitions applicable to Regulation D offerings. Rule 502(a) sets forth rules regarding integration of securities sales within a given offering. Rule 502(d) sets forth limitations on resales of securities issued in a Regulation D offering.

Nature of the Purchaser

The Proposing Release states that an issuer may be required to verify a purchaser's accredited investor status in different ways, based on the type of investor claiming to meet the standard. For example, if a purchaser claims to be an accredited investor as a result of its status as a registered broker-dealer, the issuer may rely on the information on FINRA's BrokerCheck website. However, for individual investors, the SEC has conceded that privacy concerns may inhibit the issuer's ability to obtain sufficient information about income or net worth to verify that the accredited investor threshold is met. The SEC has attempted to address the verification of individuals by means of the other factors, discussed below.

Amount and Type of Information about the Purchaser

In order to address the potential inaccessibility of information, the Proposing Release sets forth a sliding scale verification process regarding the amount and type of information obtained, whereby the more information an issuer has that indicates that a prospective purchaser is an accredited investor, the less rigorous a verification process it will need to undertake. Indeed, if the issuer has actual knowledge that a purchaser is an accredited investor, then the issuer would not be required to take any verification steps. Other types of information that an issuer could review or rely upon which might, under the circumstances, in and of themselves constitute reasonable verification steps include, but are not limited to: a) publicly available government filings that indicate sufficient income or net worth; b) third party information that provides reasonably reliable evidence of the purchaser's accredited investor status, such as Forms W-2 or industry publications regarding average annual compensation; or c) verification by a third party such as a broker-dealer, attorney or accountant, provided that the issuer has a reasonable basis to rely on such third-party verification. In light of the lack of additional guidance from the SEC, and absent the type of documentation described above, issuers could be confronted with difficult judgments as to whether additional verification may be required under the "reasonable steps" standard.

Manner of Solicitation

The Proposing Release also proposes a sliding scale verification process regarding the breadth of solicitation, whereby the more widely disseminated an offering is, the more rigorous the verification process would be. For instance, the Proposing Release notes that for a solicitation conducted through a publicly available website, a requirement that a purchaser check the box in a questionnaire or sign a form would not be sufficient to satisfy the verification requirement. Similarly, under this sliding scale approach, issuers could be confronted with significant questions regarding the level and type of verification sufficient to satisfy the requirement.

Terms of the Offering

Importantly, the Proposing Release states that if a minimum investment amount is sufficiently high that only accredited investors could reasonably be expected to meet it, and if the purchase is made through a direct cash investment that is not financed by the issuer or any third party, such evidence could be "taken into consideration" in verifying accredited investor status. The Proposing Release is silent on whether this information alone would be sufficient to satisfy the requirement, or whether the issuer has to verify that the investment was not financed by a third party.

Verification and Reasonable Belief

The Proposing Release confirms that the Rule 506(c) verification requirement does not supplant the “reasonable belief” standard that is part of the Rule 501 definition of accredited investor in Regulation D. In addition, the verification requirement is a condition of the safe harbor even if the purchaser actually meets the accredited status requirements. Thus the Rule 506(c) safe harbor would be available provided that the issuer has a reasonable belief that the purchaser meets one or more of the enumerated categories for an accredited investor under Rule 501, and it has taken reasonable steps to verify that belief, even if the purchaser does not in fact meet such accredited investor requirements. Conversely, if the purchaser actually meets the Rule 501 enumerated requirements for an accredited investor but the issuer has not taken reasonable steps to verify accredited status, the Rule 506(c) safe harbor would not be available (unless the issuer has actual knowledge that the purchaser meets one or more of the Rule 501 enumerated categories). (One hopes that this anomaly will be corrected in the final rule.) It is important to note that if an issuer has actual knowledge that a purchaser does not meet the accredited investor standard, or has knowledge obtained in the verification process that calls into question information upon which the issuer relied for its reasonable belief that the purchaser is an accredited investor, then the issuer cannot have a reasonable belief that the purchaser is an accredited investor.

Rule 506 Offerings Not Conducted by Means of a General Solicitation

The Proposing Release states that the SEC is preserving the existing ability of issuers to conduct Rule 506 offerings without the use of general solicitation and without verifying purchasers’ accredited status under the current renamed Rule 506(b) and that the reasonable belief standard of Rule 501 would be retained. Given the lack of clear guidance as to what constitutes a general solicitation, issuers that seek to avail themselves of the renamed Rule 506(b) safe harbor could unwittingly conduct a general solicitation, thus inadvertently subjecting themselves to the higher standards of Rule 506(c). Thus, if the proposed Rule is adopted, if an issuer has any reasonable question of whether it or persons acting on its behalf have engaged in a general solicitation, it should consider taking reasonable steps to verify the accredited status of the purchasers and check the Rule 506(c) box on Form D. See “Proposed Amendments to Form D” below.⁷

Proposed Amendments to Form D

The Proposing Release would also amend Form D, introducing a box that the issuer must check if it intends to rely on Rule 506(c) as well as retaining a box for the renamed Rule 506(b). It is not clear whether an issuer can check both Rule 506(b) and 506(c) boxes if it is in doubt as to whether its offering activities amount to general solicitation.

It is foreseeable that the SEC may treat a checked Rule 506(c) box as one of its risk factors in determining whether to conduct a risk-based examination of an issuer, an adviser managing a private fund or a broker-dealer acting as a placement agent.

Rule 506(c) Offerings by Private Funds

The Proposing Release confirms that Rule 506(c) offerings will not be deemed public offerings under the Federal securities laws as a result of the JOBS Act amendments (see note 1 above). Thus,

⁷ The risk of the issuer unwittingly conducting a general solicitation is not something that arose as a result of the Proposing Release. Although the risk of an inadvertent general solicitation essentially is eliminated if the issuer meets all the requirements of Rule 506(c), it is not eliminated if the issuer relies solely on Rule 506(b).

privately offered funds, such as hedge funds, venture capital funds and private equity funds that rely on the exceptions from the definition of “investment company” under Sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940, as amended, will not lose their exceptions if they offer and sell fund securities pursuant to Rule 506(c). The effect of the JOBS Act on advisers to private funds relying on certain exemptions from registering with the Commodity Futures Trading Commission (the “CFTC”) appears to be less clear. For example, both CFTC Regulations 4.13(a)(3) and 4.7 generally require the operators of private funds relying on such exemptions to offer and sell fund interests without marketing to the public in the United States. Therefore, operators of private funds relying on such exemptions still may be subject to restrictions on marketing unless and until the CFTC or its staff clarifies the effect of the JOBS Act on these exemptions.

Recordkeeping

The SEC stated in the Proposing Release that it will be important for issuers to retain adequate records that document steps taken to verify that a purchaser was an accredited investor. In addition, broker-dealers and investment advisers that assist issuers in Rule 506(c) offerings as placement agents or fund managers probably are subject to existing record keeping requirements with respect to their verification activities.

II. Proposed Amendments to Rule 144A

As mandated by Section 201(b) of the JOBS Act, the Proposing Release also proposes to amend Rule 144A(d)(1) under the Securities Act to provide that securities could be offered pursuant to Rule 144A to persons other than QIBs, including by means of general solicitation, so long as the securities are purchased only by persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs (as defined in Rule 144A). If adopted, this rule amendment would have the effect of permitting general solicitations in Rule 144A offerings.

III. Offshore Offerings

Finally, the Proposing Release provides assurances that concurrent offshore offerings that are conducted in compliance with Regulation S would not be integrated with domestic unregistered Rule 506 or Rule 144A offerings.

IV. Request for Comments

The written comment period for the draft Proposing Release ends on October 5, 2012. After consideration of comments to the Proposed Exemption, the SEC is expected to issue a final rule.

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